IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION, *Appellant,* vs. THE RAILROAD CREDIT CORPORATION, *Appellee.*	No. 10,966 (CONSOLIDATED CASES)
THE WESTERN PACIFIC RAILROAD CORPORATION (a corporation), *Appellant,* vs. THE RAILROAD CREDIT CORPORATION (a corporation), *Appellee.*	No. 10,962

CLOSING BRIEF OF APPELLANT, THE WESTERN PACIFIC RAILROAD CORPORATION.

LEROY R. GOODRICH,
Bank of America Building, Oakland 12, California,
Attorney for Appellant, The Western Pacific Railroad Corporation.

F. C. NICODEMUS, JR.,
40 Wall Street, New York City, N. Y.,
Of Counsel.

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Subject Index

Table of Authorities Cited

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PRELIMINARY STATEMENT.

There have been filed in connection with the appeals of The Western Pacific Railroad Corporation in the matters now before this Court, designated as No. 10,962 and No. 10,966, the opening brief of this appellant and the reply brief of the appellee, The Railroad Credit Corporation.

There have been filed, in the matter designated as No. 10,962, the opening brief of the appellant, The Railroad Credit Corporation, and the reply brief of the appellees, Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the members of the Reorganization Committee of The Western Pacific Railroad Company, Debtor.

The position now taken by The Railroad Credit Corporation with respect to the issues involved in these three appeals is set forth in part in its opening brief as appellant in No. 10,962, and in part in its reply brief as appellee in the other two appeals, No. 10,962 and No. 10,966. In the latter The Railroad Credit Corporation refers to and includes much of the theory and argument included in the opening brief on its own appeal.

The Western Pacific Railroad Corporation assumes, therefore, that in pursuance of the Stipulation and the Order consolidating the three appeals (R. 10,962, pp. 185, 189; R. 10,966, pp. 32, 36), it may in this closing brief refer to and analyze the contentions advanced by The Railroad Credit Corporation as appellant or appellee, in the three appeals.

ARGUMENT.

An analysis of the contentions presently made by and on behalf of The Railroad Credit Corporation with regard to the value of the new securities it receives under the Plan of Reorganization, and its claimed right to resort further to the accommodation

collateral furnished by The Western Pacific Railroad Corporation, reflect an interesting change of position from that advanced by its counsel on its behalf before the District Court, at the hearing of June 2, 1944.

1. *In the District Court,* its position was that the allotment of new securities to it was based on the amount of general and refunding bonds of the debtor which it held as collateral; that the *market value* of the new securities to be issued was totally insufficient to satisfy its claim; and that *in the event that the market values of these new securities proved to be worth less than its claim,* it was entitled to proceed against the accommodation collateral furnished by The Western Pacific Railroad Corporation. These contentions are clearly stated by the learned Judge of the District Court in his corrected Memorandum Opinion and Order, filed June 22, 1944. (R. 10,962, p. 98, at pp. 104 and 107.)

Indeed, the contentions *then* made by the Credit Corporation are further reflected by the District Court in its final Order Construing the Plan, made September 14, 1944 (and approved as to form by counsel for the RCC), in which the District Court finds: "That the rights of The Railroad Credit Corporation under its pledge agreement * * * will not be affected by the issuance of the new securities * * * and The Railroad Credit Corporation is entitled to proceed against the collateral so pledged *to the extent that the actual value* of such new securities shall not satisfy its claim." (R. 10,962, p. 143, at pp. 145-146, par. (e).)

2. *Before this Court,* it is apparently no longer contended that the Credit Corporation has not been made whole because of the market prices of the securities it received. Market prices, whether higher or lower than the values fixed by the Commission, are not now the basis of its contention that its claim has not been satisfied.

The *present* contention appears to be that the Commission fixed a maximum value on the pledged General and Refunding Bonds of $359.3367 per $1000 of principal and interest; that at this price or rate per bond The Railroad Credit Corporation has received only the equivalent of $1,437,346, in *all* the new securities allotted it under the Plan, regardless of the values fixed upon them by the Commission, exclusive of $26,091.72 received from the Marshalling and Distributing Plan; that this leaves an uncompensated balance of its claim of $1,127,486 for which it expects to absorb the accommodation collateral.

The theory by which counsel for the Credit Corporation work out a maximum value for General and Refunding Bonds is set forth on page 17 of its Opening Brief on its appeal in No. 10,962. The formula by which then then find an uncompensated balance of their claim is set forth on page 35 of the same brief.

This theory and formula are ingenious. They are unsound as a matter of mathematics, and of fact, because they ignore very vital features of the Plan. We believe they are equally unsound as a matter of law.

THE RAILROAD CREDIT CORPORATION'S THEORY AND FORMULA ARE UNSOUND IN FACT.

Counsel for The Railroad Credit Corporation say that the value which the Interstate Commerce Commission placed on the General and Refunding Bonds must be no more than $359.3367 per $1000 bond, because (a) this is the price at which $10,750,000 principal amount of such pledged bonds would pay off a debt to Reconstruction Finance Corporation, secured thereby, in the amount of $3,862,869, and (b) after making such application of pledged collateral at that value there is nothing left over for a junior lienor.

The fact is that the claim of Reconstruction Finance Corporation was satisfied *not* by application and use of its own collateral, but through the issue of the same securities, and in the same portions, as the First Mortgage Bonds, with which it was accorded a parity as compensation for its purchase at par of $10,000,000 of New 4% First Mortgage Bonds. This special treatment accorded Reconstruction Finance Corporation resulted in the allotment to it of substantially *increased* amounts of new income bonds and new preferred stock, and a very substantial *decrease* in the number of shares of new common stock as against the number of shares of new common stock which would have been issued to it, if it had been accorded the treatment warranted only by its own collateral. This decrease made available for Railroad Credit Corporation and for A. C. James Company a much larger number of shares than either would have received if they had been treated on the basis of

their own collateral, and Reconstruction Finance Corporation had not been accorded special treatment.

Under the Plan, the Commission expressed the *value of the estate of the debtor,* through its authorization of aggregate new securities (in addition to undisturbed equipment obligations and the new $10,000,000 First Mortgage Bonds issued to RFC) as follows:

New Income Bonds	New Preferred Stock	No Par Shares
$21,219,075	$31,850,297	319,441

Of these, the Commission held that the three holders of General and Refunding Bonds were entitled, by reason of a first lien on certain assets of the debtor to receive:

New Income Bonds	New Preferred Stock	No Par Shares
$ 732,010	$ 1,147,955	—

Subtracting these, the First Mortgage Bondholders held a first lien on all the remaining assets, and would be entitled to:

New Income Bonds	New Preferred Stock	No Par Shares
$20,487,065	$30,702,342	197,271 (at $57 per sh.)

On the Plan of the Commission, First Mortgage Bondholders agreed to accept:

New Income Bonds	New Preferred Stock	No Par Shares
$19,716,040	$29,574,060	230,593

They therefore accepted 33,322 *more* common shares (at $57) than they were required to take under the strict priority rule of the *Boyd* case (*Northern Pacific*

Ry. Co. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554), and they *gave up* and sent down to junior creditors:

New Income Bonds	New Preferred Stock	No Par Shares
$ 771,025	$ 1,128,282	88,847

These three junior creditors held as collateral Refunding bonds in the aggregate of $18,899,500. Of these, Reconstruction Finance Corporation held 56%; Railroad Credit Corporation, 21%; A. C. James Company, 23%.

If the new securities representing the assets on which these three creditors held a *first lien,* plus these 88,847 shares, had been divided strictly in accordance with their holdings of Refunding Bonds, the result would have been:

		New Income Bonds	New Preferred Stock	No Par Shares
RFC	56%	$409,925.60	$542,824.80	49,754
RCC	21%	153,722.10	241,070.55	18,658
ACJ	23%	168,362.30	264,029.65	20,435

In fact, the Plan adopted by the Commission and approved by the Supreme Court, gave these creditors:

	New Income Bonds	New Preferred Stock	No Par Shares
RFC	$1,186,200.00	$1,777,800.00	15,788
RCC	154,111.00	241,681.00	35,424
ACJ	163,724.00	256,756.00	37,635

By this adjustment, the Plan gave to the First Mortgage Bondholders full compensation for their claim at the values fixed by the Commission; to RFC practically all of the new Income Bonds and Preferred Stock sent down by the First Mortgage Bondholders but required RFC to send down 33,966 shares

of stock to satisfy the claims of RCC; then gave to RCC all the New Income Bonds and Preferred Stock to which it was entitled, as shown above, *plus 16,766 shares which came down from RFC,* in addition to the 18,658 to which it was entitled as outlined above. To ACJ it gave slightly less in New Income Bonds and Preferred Stock, and *sent down from RFC 17,200 additional shares.*

These additional shares to RCC and ACJ were to be taken at $62 per share; at that price they were adjudged by the Commission *sufficient to make RCC whole,* to refund in full its claim. There can be no other conclusion, because if the Railroad Credit Corporation had *not* been made whole, the Commission could not, without violating the rights of the Credit Corporation as junior lienor of the collateral held by Reconstruction Finance Corporation, allot to A. C. James Company any shares in addition to those to which it was entitled by reason of the collateral it held.

The Commission could not with propriety, or as a matter of law, give these 17,200 additional shares to A. C. James Company unless (a) The Credit Corporation had been made whole and (b) the accommodation collateral it held, furnished by this appellant, had been released.

These additional shares actually came, not from Reconstruction Finance Corporation but at the expense of the First Mortgage. Reconstruction Finance Corporation received, as pointed out, larger allotments of Income Bonds and Preferred Stock than it would

have been entitled to solely by reason of the collateral it held. These came out of the estate of the First Mortgage, and are taken out *before the Commission made its valuation of the new common stock.*

So while the Commission says in so many words that it exhausted the value of the collateral of Reconstruction Finance Corporation, it did not do so *until* it had taken out the additional elements of value which were passed down to the two junior secured creditors. The language of the Commission leaves much to be desired in the way of clarity. But it seems clear that the Commission did make a computation of the value of the Refunding Bonds pledged to secure Reconstruction Finance Corporation, as collateral, and the process by which it did so is clear.

The estate underlying the General and Refunding Mortgage, as developed under the Plan of Reorganization consists of two parts:

Parcel One: the part of the debtor's estate upon which all of the Refunding Bonds constituted a first lien, valued by the Commission at $1,879,965. Of these bonds, 56% belonged to RFC, valued at $1,052,780.

Parcel Two: 88,847 shares of new common stock of which, strictly, Reconstruction Finance Corporation was entitled to 56%, or 49,754 shares.

Reconstruction Finance Corporation's claim was $3,862,899. Deduct its share of the value of Parcel One; the difference is $2,810,089. The final mathematical problem is: at what price must 49,754 shares be taken in order to provide $2,810,089. The answer is $56.48.

It therefore seems clear that the Commission used $57 as a value on the new common stock (a) since it would make whole both the First Mortgage Bondholders and Reconstruction Finance Corporation to the full amount of their claims and (b) since it would equal and exhaust the value of the collateral held by Reconstruction Finance Corporation. Whether correctly or not as a matter of law, the Commission further found that the Railroad Credit Corporation's equity in the collateral securing the claim of Reconstruction Finance Corporation was without value. The Supreme Court affirmed this view. And this figure, it must be remembered, gives effect to the $5 differential representing compensation to senior lienors for the surrender of their first lien position and other elements of value constituting their "bundle" of senior rights.

Northern Pacific Ry. Co. v. Boyd, 228 U.S. 482, 33 S. Ct. 554;

Group of Investors v. Milwaukee R.R. Co., 318 U.S. 523, 563, 569;

Ecker v. Western Pacific R.R. Corp., 318 U.S. 448, 484, 488;

Consol. Rock Products Co. v. DuBois, 312 U.S. 510.

The figures presented and argued by the Credit Corporation as applicable to its claim fail, mathematically as well as in law, to afford any possible basis by which the claims of creditors could be satisfied. Deduct from its figure of $1,437,346 as the full value of the Refunding Bonds it held (see p. 35, RCC opening brief, No. 10,962) the value of the New

Income Bonds and Preferred stock it received ($395,-792) and there is left a figure of $1,041,554. Divide this by the number of shares it received, 35,424, and the result is a price of only $29.40 at which it would receive the *same shares which two senior creditors must accept at $57.* And still the Credit Corporation would claim the right to realize on outside, accomodation collateral!

Suppose we check it from a different point of view. The Supreme Court has held that the Commission found a total value of the estate of the debtor amounting to $84,000,000 and more. (*Ecker v. Western Pacific R.R. Co.,* 318 U.S. at 456-457.) The aggregate claims of Trustees Certificates, Equipment obligations and First Mortgage Bondholders were $75,278,128. (RCC opening brief, No. 10,962, p. 7). Clearly there was left in the debtor's estate a residue ranging from $9,000,000 upward for the three holders of Refunding Bonds. But on the basis of the contention advanced on page 17 of the Credit Corporation's opening brief these three junior creditors held bonds worth only $6,827,207 at most. (RCC opening brief No. 10,962.) *What then becomes of $2,000,000 to $3,000,000 of that residue not accounted for by the Credit Corporation's formula?*

Furthermore, if as the Supreme Court held, the value of the debtor's property soundly valued by the Commission exceeded $84,000,000, and a residue of $9,000,000 remained, *after refunding in full* the prior obligations, for the holders of Refunding Bonds, that residue was sufficient to satisfy in full the RFC and

RCC claims, and to satisfy the ACJ claim to the extent that the latter was secured. We respectfully contend that there is no other answer mathematically possible.

THE THEORY AND FORMULA OF RAILROAD CREDIT CORPORATION IS UNSOUND AS A MATTER OF LAW.

In its two briefs, the Railroad Credit Corporation reviews at great length the history of the entire reorganization proceeding of the debtor company, endeavors to interpret the provisions of the Plan approved by the Commission, states at length its theory and formula upon which it bases its contention that its claim has not been satisfied by the Plan, and that it should be permitted, in addition to accepting the full new securities allocated to it by the Plan, to hold payments of moneys from the Marshalling and Distributing Plan, and to hold and resort to the Accommodation Collateral furnished by this appellant. This it seeks to justify by an argument which it bases upon the full priority doctrine of *Northern Pacific v. Boyd,* 228 U.S. 482, 33 Sup. Ct. 554.

We believe the argument overlooks the simple essence of the law as it is repeatedly stated in the cases we have cited, referred to with approval by the Supreme Court in confirming this Plan on appeal. (*Ecker v. Western Pacific R.R. Co.,* 318 U.S. 448.) This we believe can be stated simply and briefly.

The Commission is required, in formulating and submitting to the District Court under the applicable pro-

visions of the bankruptcy act, to ascertain (a) the extent of the claims against the debtor, separately and in the aggregate, (b) to ascertain and express, either by an appraised or physical valuation of the property of the debtor, or by setting forth in terms of new securities to be issued to refund these claims, the value of the debtor's estate, and (c) to allocate these securities, not at fanciful or unsound but at true values, to the creditors to the full extent of the estate of the debtor, and in strict conformity to the rules of priority set forth at length in the cases cited by the Supreme Court in the *Ecker* case, supra.

The claims of senior creditors *must be satisfied* in full, before the claims of junior creditors may be allocated anything. Secured creditors take priority over unsecured claims. No senior creditor may be required by the Plan to sacrifice any of his full priority rights, except that a Plan may be fair and equitable wherein some new securities of the highest rank are allotted to junior lienors, and new securities of lesser rank to senior claimants, provided adequate compensation is given the latter for the sacrifice of full priority rights.

We respectfully submit that it is abundantly clear from the provisions of the Plan that this is precisely what the Commission did.

We submit that, *unless* the new securities allotted were to be accepted by the First Mortgage Bondholders in full satisfaction of their claim, *at the values* fixed by the Commission, the Plan could not conform to the doctrines approved by the Supreme Court. (TR-9714, pp. 390, 391, par. 2.) For identical reasons, the

claim of Reconstruction Finance Corporation was refunded in full. (TR-9714, pp. 391, par. 3.) And the Commission says, in so many words, that the new securities are issued *"in respect of its claim"*, not to pay off collateral bonds which it held.

We submit that in dealing with the claims of Railroad Credit Corporation and A. C. James Company the Commission used the same language. True, it recognized the value of these claims as being in proportion to the collateral held by these creditors, with the result that the Credit Corporation was paid in full; A. C. James Company, its claim being only partially secured, was partially paid but *on the same basis.* It was the *claims,* not the collateral, that were to be paid, as far as each was secured. This is all that was meant by the statement of the Commission referred to at page 19 of the Reply Brief of the Credit Corporation.

We submit that, under the law the Commission could not allot senior claimants no-par common stock at $57 per share, and junior claimants the same stock at $29.40 per share. Nor did the Supreme Court approve any such provision or plan. To have done so would have constituted a reversal of the cases heretofore decided and followed by the Supreme Court.

ACCEPTANCE OF PLAN BY RAILROAD CREDIT CORPORATION EXONERATES ACCOMMODATION COLLATERAL.

The following statement appears at page 689 of the printed record on appeal to the Circuit Court of Appeals for the Ninth Circuit in the main proceeding for the reorganization of The Western Pacific Railroad Company entitled "In the Matter of The Western Pacific Railroad Company, a corporation, Debtor", and numbered 9714 on the docket of the Circuit Court of Appeals:

> "8. Paragraph O declares that the approval and confirmation of the plan shall in no wise disturb or alter the right and interest of the R.F.C. and the R.C.C. in collateral pledged with them by parties other than the debtor.
>
> "Obviously the R.C.C. will not accept out of hand a plan which does not adequately provide for its claim, especially when acceptance would cut off the security of collateral pledged with it by third parties. Whether such security (656) is cut off or not is dependent upon established principles of law which cannot be altered by any provision in an order of this Commission."

The foregoing is an extract from the Petition dated December 9, 1938, filed by The Railroad Credit Corporation asking a modification of a Plan of Reorganization approved by the Interstate Commerce Commission by its Report and Order dated October 10, 1938.

This statement made by The Railroad Credit Corporation over the signature of its own counsel is a correct statement of the law as we understand it. In

calling this statement to the attention of the Circuit Court of Appeals, we respectfully call attention to the following allegation in the Bill of Complaint of The Western Pacific Railroad Corporation against The Railroad Credit Corporation, No. 10,966, Rec. page 4:

> "That subsequent to the decision of the Supreme Court of the United States rendered March 15, 1943, said Plan of Reorganization was submitted by the Interstate Commerce Commission pursuant to said Section 77 of the Bankruptcy Act, as amended, for acceptance or rejection by all classes of creditors of The Western Pacific Railroad Company entitled to vote thereon, and was accepted by more than 66⅔% of each class of such creditors including the defendant, The Railroad Credit Corporation, which took such action without asking or securing the approval and consent of the plaintiff as the owner of the accommodation collateral hereinbefore specified."

We respectfully submit that the claim of The Railroad Credit Corporation has been paid in full by the new securities allotted to it; that the values at which they are to be taken are now *res adjudicata;* that the Plan, and the provision for the funding of its claim, were accepted by the Credit Corporation; that the accommodation collateral furnished by this appellant is exonerated; that the Order of the District Court made June 19, 1944, and the Judgment entered August 7, 1944 in action No. 23,307-S in said Court should be reversed; and that the Order Construing Plan of Reorganization, made September 14, 1944 in the District Court, and particularly paragraph 5 thereof deal-

ing with the Accommodation Collateral should be reversed.

Dated, Oakland, California,
June 1, 1945.

LEROY R. GOODRICH,
Attorney for Appellant,
The Western Pacific Railroad Corporation.

F. C. NICODEMUS, JR.,
Of Counsel.